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"Using FHA for Housing Stabilization and Homeownership Retention"

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Thank you, Mr. Chairman. I appreciate the invitation from you and Ranking Member Bachus to testify this morning.

The Administration has taken decisive action to help responsible homeowners stay in their homes. The Administration launched the *FHASecure* initiative and facilitated the creation of the HOPENOW Alliance, which together have helped more than a million struggling homeowners.

Mr. Chairman, I think we all agree that we must use government resources wisely and judiciously. We must help responsible families in need, without transferring risks and costs that should be borne by the private sector to the taxpayer. I know that we all want to find a way for FHA to help more Americans keep their homes and avoid foreclosure.

However, I believe most Americans want to protect homeowners who played by the rules. They don't want to reward risky financial behavior. And they don't want to make the Federal government the lender of last resort, with the private sector dumping bad paper on FHA and taxpayers.

We must not federalize the housing market. And we must not harm our economy through solutions that, however well intentioned, further erode the foundation of the nation's housing market, hurt homeowners who are meeting their mortgage obligations, or prolong the correction.

Mr. Chairman, Congressman Bachus, this Administration has acted swiftly to address our housing problems and we are prepared to do even more. There are some good ideas embodied in legislation under consideration, including your own. But some ideas stretch FHA well beyond its role or ability to serve the American people appropriately.

For the last two years, the Administration has suggested ways to improve the agency's ability to fulfill its mission to help low-income and first-time homebuyers who are not served by the conventional mortgage market. I believe FHA should remain true to its mission. FHA Modernization is one constructive step, a step I know you have strongly supported, Mr. Chairman and Congressman Bachus. And I want to thank the Committee for that bipartisan support. The Administration continues to urge Congress to reach agreement on a bill to modernize FHA that the President can sign it into law.

However, Mr. Chairman, there are two key components that must be part of any final FHA Modernization bill.

First, we must maintain FHA's ability to offer a fair and equitable mortgage insurance premium structure that is commensurate with the risk presented by the loans it insures. Any bill must give FHA the tools needed to price for additional risk. Unfortunately, neither the House (H.R. 1852) nor Senate (S. 2338) provisions succeed in accomplishing this. Instead, the Senate bill would impose a 12-month moratorium on HUD's proposed modification to the current FHA premium structure. To ensure the solvency and continued operation of FHA's single family mortgage insurance fund, flexible risk-based premiums are necessary both now and in the future. FHA currently is self-sustaining. As you know, few government programs can claim the same. We do not want to cross that line, particularly at a time when we are most needed, and as I have testified to other Committees, reforms or changes to the program are already needed to avoid crossing the line in October at the start of FY 2009.

Second, legislation must include a provision, like that in S. 2338, to expressly prohibit down-payment assistance from the seller or any other person or entity that stands to benefit from the transaction financially. Insured loans relying upon seller-funded down payment assistance have been demonstrated to have an unacceptably higher risk of default and foreclosure – harming borrowers they intend to help and risking the integrity of the entire FHA program and its ability to help more at-risk low- and moderate-income homeowners. Data clearly demonstrates that FHA loans made to borrowers relying on seller-funded downpayment assistance go to foreclosure at three times the rate of loans made to borrowers who make their own downpayments. We simply cannot sustain this business. We want FHA to be here not just for this generation, but for generations to come.

FHA Modernization has bipartisan support. It is the appropriate next step to address the housing downturn. Congress needs to make this important bill an immediate priority over other housing proposals that are under consideration. As a first order of business, a good FHA Modernization bill must be sent to the President.

In addition to FHA Modernization, the Administration believes that additional, responsible actions can and should be taken with respect to expanding temporarily the *FHASecure* program. We think there is more we can do with *FHASecure*, rather than creating a new refinance product. The Administration announced this program last year to help more low-to-moderate income families who could not otherwise qualify for prime-rate refinancing. To date, we have served more than 150,000 homeowners in need, and our projections show that we will likely reach more than 400,000 families by year's end.

We believe that the reach of this program can and should be extended in a responsible way. Any expansion of *FHASecure* should continue its temporary nature and be focused on helping homeowners who are financially able and responsible, but who cannot refinance and stay in their homes without FHA assistance.

Expansion of *FHASecure* also would need to be achieved in a way that is consistent with the Administration's principles on FHA Modernization. An expansion of *FHASecure* should include special underwriting flexibility to help more families qualify for FHA-insured mortgages. This includes making eligible more borrowers who were late on a couple of mortgage payments. These underwriting changes could also be made in exchange for lenders voluntarily writing down some of the outstanding mortgage principal if necessary to attain a prescribed loan-to-value ratio, and/or balanced with insurance premium adjustments when necessary to protect both the FHA insurance fund and the taxpayer. Again, FHA operates as a negative credit subsidy program, which means that it does not require Federal appropriations for its credit subsidy cost. Rather, the FHA program is funded through insurance premiums that homeowners pay themselves.

I believe these actions are consistent with our shared view that a robust FHA is needed to address the housing situation. However, it is essential that Congress not legislate specific underwriting criteria that would unnecessarily limit FHA's flexibility.

Certain bedrock principles also need to be maintained. For example, we require that an eligible family live in the FHA-insured home and have documented, verifiable income. That's something that FHA has always done, but in the era of no-doc loans, was a bit of an anomaly. As you know, Mr. Chairman, many of the problems in the housing market have occurred as a result of lax underwriting standards, and FHA should not be forced legislatively to compromise its fundamental criteria at the future expense of the taxpayer. Furthermore, any expansion of the program should allow FHA to establish a new and more flexible pricing policy for its insurance products at rates sufficient to ensure the safety and soundness of the single family mortgage insurance fund. Basing mortgage insurance premiums on the individual risk of each loan, where risk is judged using traditional underwriting standards, is the best way to ensure that the taxpayer is protected and that FHA can help more families stay in their homes. It's how every responsible insurance company operates.

Mr. Chairman, I will now comment on the specifics of the legislation that brings us here today.

While we appreciate many of the concepts that underlie Title I of your bill, the Administration has serious concerns about several provisions. For example, we have concerns that Title I in the draft House bill is not sufficiently targeted and mandates a loosening of underwriting criteria that could saddle borrowers with unacceptably high debt payments, placing them and the FHA fund at risk. We are concerned about the bill's very prescriptive approach. For example, your proposal would have lenders disregard some underwriting criteria and allow borrowers with much higher debt-to-income ratios to be eligible. Preserving FHA's administrative flexibility, to help homeowners and protect taxpayers, is important. The mandatory write-down of principal on the part of existing lien-holders and compulsory waiver of prepayment penalties suggest that Congress expects lenders and investors to simply accept losses, regardless of the contractual obligations imposed by the securities in which the loans are held and the market conditions affecting the borrowers. In addition, the bill requires lenders to disregard current credit scores or delinquencies on existing mortgages when assessing whether a borrower has a reasonable expectation to pay the mortgage. The bill also would allow FHA to insure borrowers with much higher debt-to-income ratios than we think is appropriate.

Instead of creating a new program in another account, we support expanding *FHASecure* within the Mutual Mortgage Insurance Program Account while increasing its aggregate loan guarantee limit so that FHA can serve more needy borrowers. Finally, the "exit premium," to be structured as a subordinate lien payable to FHA, could accomplish the same goal through a simple deed restriction without requiring additional legislative authority. In essence, we believe that there are simpler and more targeted ways to accomplish the goals of the bill, relying on the existing market forces and practices.

We also strongly oppose Title II and similar provisions in the Senate version that would allow lenders or servicers to sell bad loans to the taxpayers through an auction process, clearinghouse, or some other wholesale mechanism. We do not believe that it is necessary to create an

Oversight Board and a new auction mechanism in order to encourage mortgage holders to sell portfolios at a discount to new investors whose servicers would write down the existing mortgages as permitted under Title I. The market does not need a government entity to play this role in such a transaction and the capacity of the board will be fairly limited. With the *FHASecure* expansion, these sales can occur in the private market, because the potential purchasers will be able to refinance new loans under FHA's rules that permit the write down and refinancing of delinquent loans.

We strongly oppose Title III of the draft House bill as well, which would provide $10 billion in loans and grants to States and local governments for the purchase and rehabilitation of vacant, foreclosed homes. In addition to being extremely costly, such a program would constitute a taxpayer bailout of lenders and speculators, while doing little to help keep struggling families in their homes. As with similar proposals, the principal beneficiaries of this type of plan would be private lenders, who are now the owners of the vacant or foreclosed properties. In addition, it may have the unintended consequence of making foreclosure a more attractive option for lenders. While community stabilization is a worthy goal, using Federal resources to purchase properties from lenders who could already be helping to prevent the foreclosures represents a clear moral hazard. Lenders can and do already work with state and local governments to transition excess properties to good public use; a new program of this scope may do more harm than good.

Mr. Chairman, these are our initial thoughts about the bill. I again stress that there is a lot of common ground here given our shared interest in using FHA to help many Americans. I look forward to working with you and the Committee to do just that. Thank you again for inviting me to testify today.